RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Feb. 23 DJIA 2564.19; PTI 3245; A-D Ratio -10.73
Mar. 2 DJIA 2660.36; PTI 3268; A-D Ratio -9.90
Dow Yield: 3.81%; Dow P/E: 11.8; DowPow: 296
Dow Book Value: 1075; Dow 200-day MA: 2638
Percentage of Undervalued Blue-chips: 22%
PTI 89-day Moving Average: 3278

THE PICTURE: "Bo knows football." But does Alan Greenspan know markets? I guess we'll find out over coming months, but I must admit I'm a bit skeptical of Greenspan's optimism regarding the US economy (actually, I believe Greenspan is hoping more than anything else).

Greenspan optimistic on economy

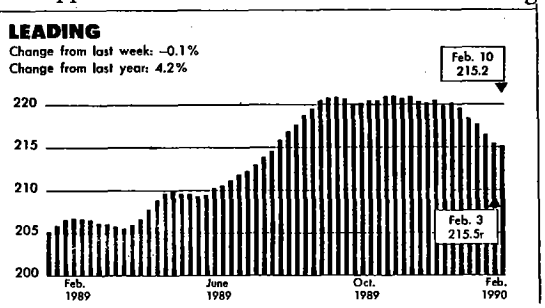
Alan Greenspan
Recession not likely

New York Times News Service

WASHINGTON — Alan Greenspan, chairman of the Federal Reserve Board and the dominant force in economic policy-making, yesterday told Congress that the economy's "weakest point may have passed" and that the nation could expect "moderate economic expansion" this year.

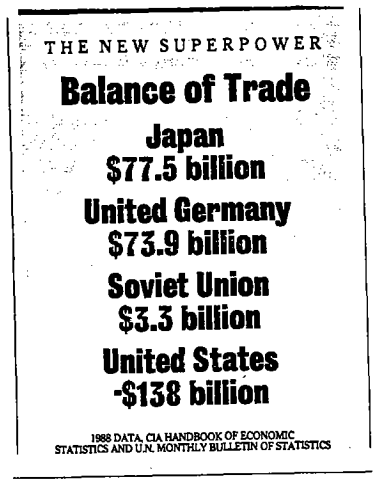
The fact is that Greenspan and the Fed are walking a tightrope. If the US economy picks up, inflation will probably flare up. If the economy sinks into recession, bankruptcies due to over-leveraging and mile-high debt will send thousands of US companies to the wall. On top of all this, interest rates are pretty much out of the Fed's control, due to the US's debtor-nation status and due to rising interest rates in Japan and Europe. So if Greenspan is singing at all, he's probably singing Johnny Cash's old song, "I Walk the Line."

One thing worth watching -- *Business Week*'s Leading Index of Business, which topped out last November and has been sliding ever since.



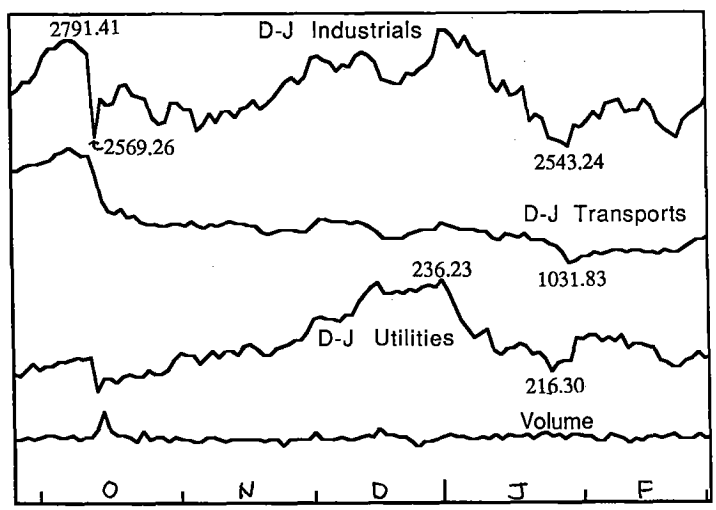
My work tells me that we're in a primary bear market (via the Dow Theory and my PTI). And despite the Fed Chairman's optimistic view, bear markets do not have a history of being accompanied by healthy economies. True, we're living in amazing times. The 40-year-old cold war has pretty well died out along with the Soviets' hopes for an all-Communist world. And the two superpowers, the US and the Soviets, are looking less super with each passing month. The Soviet empire has come unglued with shocking rapidity. The US has faded much more slowly and subtly, but the fading is apparent if one examines the path of the dollar over the past five years or if one looks at the unbelievable buildup in US deficits and debts.

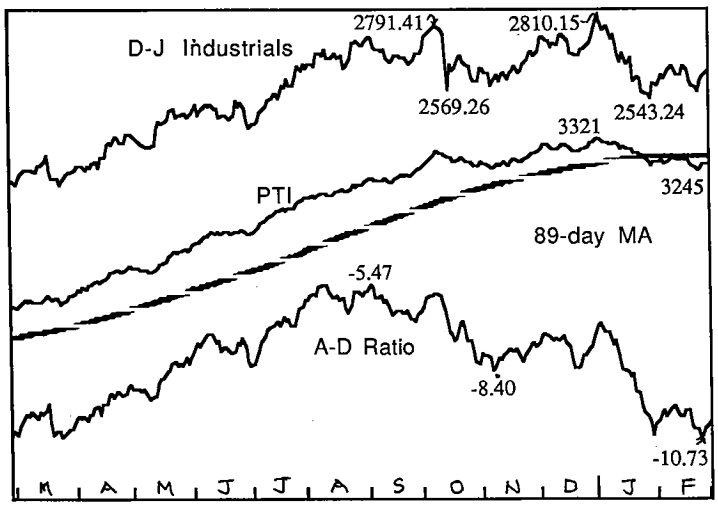
One measurement of a nation's economic prowess is its ability to sell its products to the world. Along these lines, *Newsweek* magazine (Feb. 26) published this little rundown, and you'll have to admit that it provides food for thought.



World peace should be bullish, and hopefully in the long run it will be bullish. But the sudden appearance of peace brings along with it some weighty problems. One problem is that huge quantities of money will be needed to reindustrialize Eastern Europe. When large amounts of new money are created, there is always the potential for inflation. Another problem is that peace will bring with it major dislocations in industry, specifically in that giant spending machine -- the US defense industry.

"But what about the bullish side of the equation, what about the 'peace dividend'?" you ask. At this juncture, I'm sorry to report that there is no peace dividend, at least there isn't one here in the US. The fact is the Bush administration is planning for an actual increase of about $7 billion in defense spending in 1990 over 1989. Any ultimate cutback in defense spending will be slow in coming,





and Congress will fight the cutbacks tooth and nail, particularly where a specific cutback impacts on a specific Congressman's home territory.

You see, sadly, it worked like this. Ever since 1945 the US and the Soviets have been fighting a cold war with accompanying massive arms buildups. The cold war ended in 1989-90. It ended with the Soviet empire in a state of collapse and the US leveraged to the hilt and sinking in debt. The cold war winners -- Japan and Germany.

THE MARKETS: Bear markets arrive when least expected and when least convenient for all concerned. Thus, is it not without irony that this bear market has appeared just when peace and democracy are breaking out all over the world?

I should mention a few significant factors here. (1) Indicators in bear markets don't work the way they do in bull markets. For instance, what constitutes an oversold situation in a bull market will not suffice in a bear market. In a bear market, the oversold areas tend to be far more severe than those which appear in a bull market. By the same token, the overbought conditions in a bear market tend to be far less impressive than in a bull market.

(2) Roughly 80% of today's stockbrokers were not around during the last primary bear market, which occurred in 1973-74. Therefore, you can expect a steady stream of bad advice to pour out of the brokerage houses. It will be optimistic "buy, buy" advice, and in the main it will turn out to be costly advice.

(3) Today the world's markets and economies are interconnected as never before. The fact is some nations are in comparatively good shape while others are on the verge of bankruptcy. This divergence will provide an erratic and difficult background for the bear market. Furthermore, huge amounts of "hot money" will travel from one nation to the next with instant (electronic) speed. Billions of dollars (or yen or marks) rushing from one border to the next will make for exciting but often baffling market trends.

(4) Despite the fact that information and transfer of funds is now literally instantaneous, I believe this bear market could be long and drawn out. Consider this -- it took 45 years of inflation and debt buildup to put the US where it is today. And where are we? We're sitting on the greatest mountain of debt the world has ever seen. Consequently, I believe the 1990s will be a period of debt liquidation accompanied by a gradual return to fiscal sanity.

To put it another way, what took 45 years to produce is not going to unravel in six months. Consequently, I look for a long, difficult, deceptive bear market, a bear market that could even be broken up by mini-bull markets such as those that occurred during 1946-49 or 1966-74.

(6) Currently, the pressing problem for the markets is the "unexpected" rise in world interest rates (not unexpected, I trust, for readers of these Letters, since no one was more skeptical of the bond market and rates than I was). Interest rates and currency differentials will make for continuing and very difficult problems during the life of this bear market.

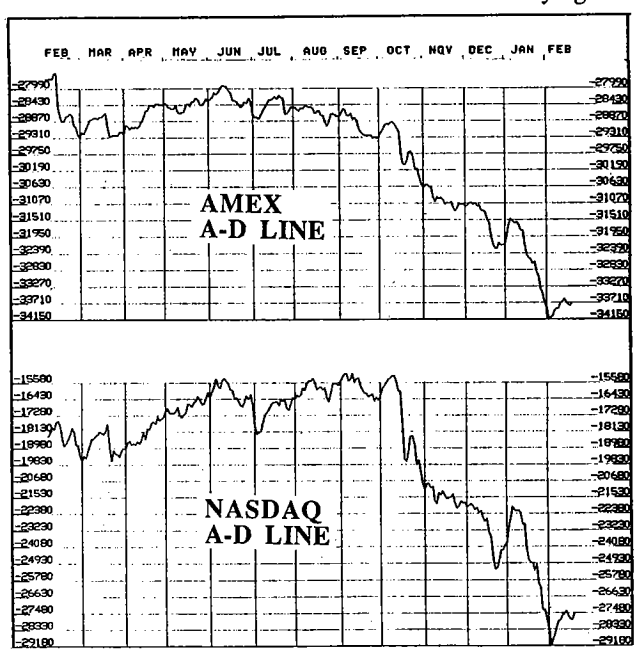
(7) Rating agencies such as S&P and Moody's have been downgrading debt on almost a daily basis. This is putting steady pressure on junk bonds and even on bonds of semi-investment grade. Furthermore, as corporate earnings decline (and they do during a bear market), an increasing number of debt-logged companies will be forced to reorganize or to declare bankruptcy.

Many of these battered firms, I'm afraid, will be taken over too soon by investors seeking to make a killing on the back of someone else's disaster. What I'm saying is greed will continue to be part and parcel of the corporate scene. Greed combined with good timing works (ask Henry Kravis). Poorly timed greed (which one often sees during an extended bear market) only produces further and more disastrous losses.

PRICE ACTION: On January 30, the D-J Averages recorded lows of 2543.24 for Industrials and 1031.83 for Transports. Neither Average has been lower since. Following the January 30 lows the market rallied, with the Transports showing the best percentage rise.

When a tennis ball is dropped from 10 feet, it will normally bounce back three or four feet. The exact same principle applies to the stock market following a severe decline. Do you realize, for instance, that the D-J Transportation Average topped out on September 5 at 1533.01? From that high the Transports slumped to 1031.83 on January 30. The decline represented a loss of 33% of the entire value of the Transportation Average. Thus, the recent bounce (or correction) was overdue and should come as no surprise.

Technically, the market was very oversold at the January 30 lows. Nevertheless, the rally since then has been rather unimpressive, particularly from the standpoint of breadth. Since January 30, we have seen only a single day in which the NYSE produced over 1,000 advances (that was on January 31). On February 23, the advance-decline ratio (see page 2 chart) actually broke to a new bear market low -- but the low was not confirmed by the Averages. That price-breadth nonconfirmation set off further rallying action,



but as this is written the upside action continues to be unimpressive.

The advance-decline action has been poor on the NYSE, but it has been disastrous on both the NASDAQ and the AMEX exchanges. The charts on page 2 (courtesy of *Mansfield*) attest to that. Note that the breadth index on the AMEX has been declining ever since last June, while the NASDAQ breadth index topped out a bit later, in October.

I mentioned the damage this bear market has done to the Transportation Average. But the losses have been much more widespread than simply the carriers. For instance, the broad Value Line (geometric) Average is fairly representative of the average US stock portfolio. As of mid-February the Value Line was within a few percentage points of its December 30, 1988 closing level. That tells me that for the typical portfolio the bear market had wiped out literally all of the gains of 1989-90.

My Primary Trend Index (PTI) continues in a downtrend (page 2 chart) and is currently 18 points below its 89-day moving average. Thus, it remains in the bearish mode. The 89-day moving average of the PTI is now trending down (it turned down on February 12), and this action lends authority to the bearish mode of this indicator. As long as the PTI holds below its declining 89-day MA, this indicator will be saying that the market is in the grip of the bear.

Conclusion: This market has been in an oversold condition since late-January. Since then, the market has been "working off" its oversold condition. Classically, according to Dow Theory, a correction is entitled to recoup one-third to two-thirds of the ground lost. Whether this upside correction can do that remains to be seen. In my opinion, if we are to see a full correction, the breadth figures will have to improve substantially. As I said earlier, we have only witnessed a single day of impressive breadth since late-January. The day appeared one day off the lows -- on January 31.

INVESTMENT POSITION: The bear is in the box, but since late-January he's been hiding. But just in case you're confused, remember this -- a rally in a bear market simply corrects an oversold condition. The rally has nothing to do with fundamentals or an improving economy, it's simply a correction of a market that has gone too far or too fast on the downside.

With foreign interest rates moving up sharply, the pressure has quickly spread to US interest rates as well. The result is juicy short and increasingly juicy long rates in the US. Consequently, I've moved my own assets largely to 91-day Treasury bills, which now provide an effective yield of over 8% (and remember, you pay no state taxes on T-bills). Considering their super-safety, that's a bargain during bear market times. On top of that, the dollar was oversold and is now rallying or let's say it's correcting to the upside.

Gold is working off the over-enthusiasm generated by its recent runup to the 420 area, and sentiment towards the precious metals is now turning negative. All this with gold holding above 400. Good. Continue buying those Krugerrands, Maple Leafs, Kronas, Eagles, etc. They're not going out of style.

THE DOW: Regardless of complaints (and there are always many) regarding the D-J Industrial Average, this Average (actually it's an index because it is adjusted) remains an excellent proxy for the blue-chip sector of the market.

But why are blue-chips important? They are important because these are the stocks that informed, seasoned investors tend to buy. And in the stock market, there is nothing more important than the action of informed and seasoned investors. Steady, relentless buying of high-grade stocks forms the basis for every primary bull market. Steady, relentless selling of blue chip stocks is the force that has fueled every primary bear market.

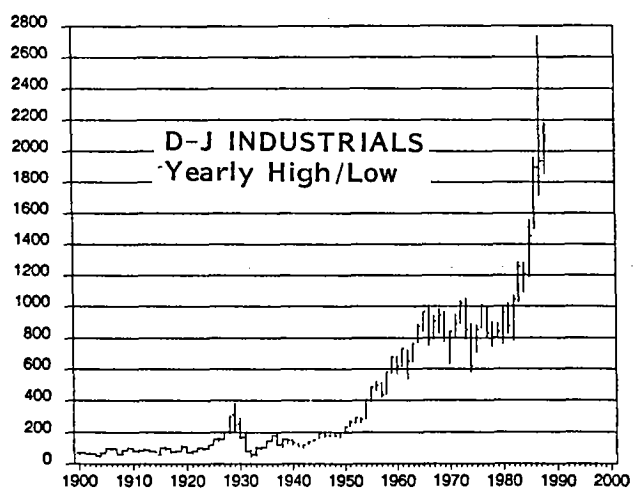
So that's why the action of the Dow is so critically important, and don't let anyone tell you otherwise. Aside from the above, the Dow is important because rightfully or wrongfully, the public equates the Dow with "the market." When your neighbor asks you how the market closed, he's not referring to the Value Line Composite or *Barron's* Low Priced Stock Index -- he's referring to the D-J Industrial Average.

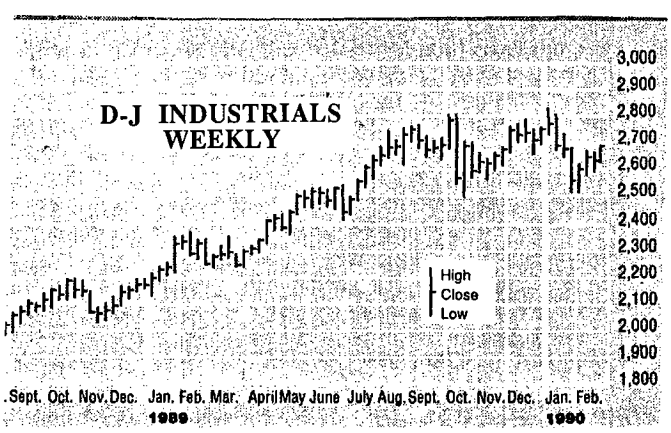
So let's talk about the Dow. Charts covering different time periods often provide instructive and significant views of what is really going on.

Recently, I was struck by two charts of the Dow, both arithmetic scale. The first chart (courtesy *Cycle* magazine) is a yearly chart of the Dow, each vertical bar covering the high-low Dow range for that year. I study this chart and I ask myself, "If this was a stock, would I buy it?" My answer is, "No, because what I see here is a 'consolidation period' during the 1970s and early '80s and then a parabolic "blow off" during the late '80s -- a blow off that ended in 1989 at just over 2800 on the Dow." And as veteran subscribers know, after a parabola comes -- trouble.

So that's one view, based on the yearly high-low range. The other view that I thought was significant is seen on this weekly chart of the Dow. From the weekly chart standpoint, it is immediately apparent that a double-top exists at the Dow 2800 level and a double-bottom exists at the Dow 2500 level. A breaking of either of these levels would be very important and would almost surely carry the Dow considerably further in the direction of the breakout.

Since this is a confirmed bear market, the odds are that the ultimate breakout will come to the downside. A breaking of Dow 2500 would present the picture of a massive top in that Average with the 2500 level then representing formidable resistance to any rally attempts.





FINANCING EASTERN EUROPE: Each day I read 10 newspapers and maybe five magazines (plus an occasional book). To be honest, I do it because the news and world trends fascinate me. But I also do it because it takes that much reading from various sources in order to piece together what is happening in the world.

Here's the way it works (at least for me). After I read a few dozen sources on a specific theme, I *begin* to get a feel for what's going on. If I'm lucky, there's a sort of flash of recognition. When that happens, I relay the results of my research to subscribers. Some of these news items and brainstorms appear in the Notes & Quotes section. My one frustration is I wish I had more space. I could easily fill 10 pages of "Notes & Quotes" every week.

OK, this week's thought: It's going to take new mountains of money to keep East Germany and Eastern Europe afloat, and then to industrialize these areas. But industrialize them we will -- or at least the West will, count on it.

The ostmark (East German mark) is now worth only one-sixth of a German mark (less on the black market). Somewhere along the line there will have to be a swap, ostmarks for marks, and that's going to cost West Germany billions (there's even talk of a one-for-one exchange limited to East German bank accounts). Ultimately, the new unified Germany will have to have a single currency. With unification comes major expenses. The generally accepted figure is that East Germany will cost West Germany $12 to 18 billion a year for the next 10 years. The "floating" of East Germany will cause Bonn's budget deficit to boom 50%, to near $27 billion this year alone.

The Germans are terrified by inflation. The German economy was literally wiped out by inflation during the 1920s. And they remember. Consequently, the German central bank will fight inflation tooth and nail. Short-term rates in West Germany have already pushed to 9%. And there's a good chance they'll go higher.

On top of the German situation, huge amounts of the world's private capital will flow into Eastern Europe. This will divert capital from the US, capital that would ordinarily go into US Treasury bonds -- and this will be a problem.

David Hale, Kemper Financial Services' financial expert, notes that during the 1970s the world banks lent over $400 billion to Latin America and $100 billion to Eastern Europe. He further notes that during the 1980s the US was able to borrow over $1 trillion externally, mainly because the developing countries followed restrictive monetary policies, thus freeing up large amounts of the world's funds.

But during coming years Hale thinks East Germany alone could borrow as much as $600 billion from the West with the rest of Eastern Europe clamoring for hundreds of billions of dollars.
The net result: higher rates in the West including, of course, the US. And if business picks up in the US, today's rates will look low. Finally, the higher rates will put pressure on the US to address its chronic budget deficits.

Note: It is ironic that just as the US thinks in terms of an end to the Cold War, a "peace "dividend" and perhaps addressing its budget deficits, this new need for capital descends upon the world.

All in all, the 1990s are shaping up as a mighty interesting and difficult period. Three themes coming out of all this are as follows: (1) the West will need to raise huge amounts of capital (2) resulting in pressure for higher world interest rates and (3) rising inflation brought on, among other things, by massive world loans and spending programs.

NOTES & QUOTES: After two years of bad news about tax receipts, New York state's finances are moving into the crisis stage. With revenues dropping sharply due to poor business, the state's budget shortfall this year is expected to grow to over $1 billion while long-term or accumulated debt will reach $5 billion. This year the state is expected to issue $600 million in deficit notes, the most ever. Standard & Poor's has put a "negative outlook" on the state's credit. If NY state's credit rating is downgraded, it will boost their borrowing costs and the crisis will deepen.

* *

Speaking of troubles, the sentiment in Russia is as follows: Gorbachev folded the old system (which didn't work anyway), but failed to institute a new system. From the standpoint of the Russian man on the street, what's changed? Well, today, people are allowed to congregate on the Soviet streets and complain that the economy is worse than ever.

* *

Castro's days as dictator of Cuba are almost surely numbered. Cuba has been receiving $7 billion in subsidies from the Soviets, subsidies which have kept the Castro government afloat. But there's no way the bankrupt Soviets are going to continue this give-away. So watch Fidel.

* *

Ah money: S&L bailout legislation enacted last August provided $50 billion through next year to cover losses in failed thrifts (yeah, they still call them thrifts, can you believe it?). But the Resolution Trust Corp. needs probably another $100 billion. This borrowing will supposedly be paid back as the government sells off assets of the failed thrifts. But the big question is how this borrowing will affect the deficit. The Administration's fear is that it will appear as an increase in the federal budget. Can they put the additional borrowing "off budget"? Congress will have to decide.

* *

It is estimated that it would cost $500 billion to replace all US copper wires with advanced optical fiber cables. I don't think that's going to happen any time soon. But it's going to happen in Japan -- they're planning on it, as this article states. The advantage such a system will give Japan is enormous. It's obvious Japan wants to become the most advanced technological nation in the world.

TOKYO — Nippon Telegraph and Telephone Corp. says it will spend an estimated $210 billion by the year 2015 in replacing its 51 million miles of copper telephone lines with advanced optical fiber cables to build a nationwide integrated services digital network (ISDN).

ISDN, one of the most advanced telecommunication technologies, has large-scale and high-speed data-transfer capabilities. It can transfer simultaneously various forms of information, such as voices, visual images and digital data, providing a single interface to which telephones, facsimile machines, computers, and videotex machines can be connected.

Clients will be able to communicate with friends through both videophone and facsimile. The network will also enable clients to hold high-quality television conferences among conferees in multiple remote places, NTT said.

Also available will be a wide variety of new services, including electronic newspaper delivery, "telewindow" shopping and on-demand TV that gives clients a choice of programs at any time of day, the spokesman said.

* *

The strangest thing about the Drexel Burnham fiasco was that just weeks before the bankruptcy declaration, CEO Fred Joseph didn't have any idea of what was going on. Proof: A few weeks before the bankruptcy, Drexel gave out bonuses of $196 million in cash and $64 million in Drexel stock. Joseph elected to take his $2.5 million bonus in stock. The stock is now worthless!

* *

I love Gore Vidal, the original iconoclast. The man is always outrageous, and most of the time there's more than a bit of truth in his outrageousness. Recently, Gore was interviewed by *Elle*. Here are a few excerpts: Question: What strikes one most about American cities now is the violence. VIDAL: Well, once you make the decision, as they did immediately after WW II, to turn the country into a National Security State, to use half the revenues of the country for something called defense, you have to abandon the educational system, abandon the programs to help minorities, and the results are predictable. Now, of course, we've run out of money. We spent it all on weapons.

. . .

Question: That unifying culture did exist in the period you describe in your book, Hollywood. Does it still exist in Washington? VIDAL: Well, it's sad now. Washington seems like a colonial

white outpost somewhere in black Africa. There they all are, sitting behind the stockades -- government, the rich whites in Georgetown -- surrounded by the very, very angry black people who are not a part of society. A country that has to live with that in its capital is in great trouble. Question: With the collapse of the Soviet empire, so many people are saying that US policy during the Cold War has been vindicated. VIDAL: The Soviets are not cracking up because of anything we did or didn't do, other than perhaps keeping them armed to the teeth. But then we've collapsed too. They don't have any food, and we don't have any education.

* *

With 750,000 lawyers in the US already, I often wonder how the legal profession can continue to hire ever-more lawyers. "Where will they get all the new business to support all the lawyers?" I asked my wife, Faye, who will be graduating from law school this May. Ah, now I have the answer. William Seidman, Chairman of the Federal Deposit Insurance Corp. and of the Resolution Trust Corp., has instituted 40,000 lawsuits against troubled S&Ls. And he expects to double this number by the end of the year. Seidman has hired a staff of 1,900 people while merging his agency with the S&L Insurance Corp. Quipped Seidman last week, "We are well on the way to creating a shortage of lawyers." With the government deep into the bailout act, you can believe it.

* *

Say good-bye to the magic "under 10% 30-year mortgage rate." The rate pushed over 10% a few weeks ago and appears headed for 10.5%. This will impact housing.

* *

Meanwhile, our government is explaining away the whopping 1.1% jump (13% annualized basis) in inflation for January. "Take out food and energy and it's not that bad," Washington says. Of course, without food and energy, inflation is still running at a 7.2% rate. But who do you know who doesn't drive and doesn't eat? At any rate, we'll wait patiently for the February figures, along with the next round of absurd excuses.

* *

I've quoted climatology expert, Dr. Ibin Browning, before. Browning believes that human beings are not in control of their fate, that climate is. Massive crop failures, not peaceful intentions, he says, drove Gorbachev to the negotiating table. Browning states that a cooling weather cycle has been gripping the northern hemisphere. Based on his weather cycle studies, he believes a depression is on the way, and that it will not end until 1993. Cold winter and cold springs will be in our future until then, warns Browning.

* *

Most depressing facts of the month: Americans can't build prisons fast enough. The total US prison population is now over 1 million, rising 11% last year. One-fourth of all young black men are in prison, in jail, or on probation. Incredible: 610,000 young black men are under the criminal justice system, 436,000 young black men are in college.

* *

Here are world costs (per square foot) for prime office space in downtown locations: Tokyo $159, London $116, Hong Kong $100, Paris $69, Sydney $56, Zurich $51, NYC $49, Toronto $47, Madrid $47, Wash. DC $47, Moscow $47, Singapore $45, Chicago $39, Buenos Aires $36, Taipei $36, LA $33, San Fran. $30, Detroit $25, Phoenix $24, Kans. City $23, Portland $23, Dallas $21 (see why corporations are moving there?), Reno $19 (and low, low taxes), Seattle $19, Denver $12, Lima $7, La Paz $6, Asuncion $2.

* *

The question all Wall Street is asking -- "Is Donald Trump overextended?" In Atlantic City the casino business is hurting, and this is squeezing profits at Trump's two casinos. Soon Trump will be opening the giant Taj Mahal casino, and it is thought that the Taj will draw customers away from his two other casinos. Bonds that financed the Taj are now selling at 76 cents on the dollar. Experts say the 4.5 million square feet Taj will have to make $1 million a day, just to break even (something no other casino has ever done). As far as Trump's Plaza hotel, experts say the Plaza will have to book all 814 rooms at $500 a day every day in order to work. In LA, Trump owns 23 acres on which he intended to build a Trump City. But now the LA School Board wants the land for schools and calls Trump's ambitions "a blatant disregard of the needs of this community." LA could take the property via eminent domain. Then there's the divorce. Well, Trump always loved excitement.

* *

Could life and health insurance companies be the next S&Ls? According to Marty Weiss (*Weiss Research*, Box 2923, W. Palm Beach, FL 33402), among the 251 largest life and health insurance companies (assets of $500 million or more) 24% of them hold as least 15% of their assets in bonds that are rated BB or lower or in unrated bonds. By the way, any bond rated BB or lower is considered "junk."

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Russell's adage for the week: "There are no gurus on Wall Street -- only survivors."

* *

On Feb. 20 *USA Today* conducted a fascinating interview with Alum Chalfont, head of the British negotiating team for entering the Common Market. Here are some comments:

USA TODAY: This European plan means more than just the free flow of products, doesn't it?

CHALFONT: It means EC financial institutions will be able to operate in any country and move capital freely across borders. Professional qualifications will be universal, too. A British doctor, or an Italian architect, will be able to do business anywhere in Europe.

USA TODAY: Will there be a common currency?

CHALFONT: We will have common exchange rates, but I would rule out for the foreseeable future any chance of a com-

USA TODAY: What impact will this have on the USA?

CHALFONT: It will be difficult for U.S. firms to export to Europe. There is bound to be a tendency for Europeans to prefer European goods. Unless they get over there and become part of the EC industrial base, they might be in trouble.

USA TODAY: Is Japan moving faster than the USA?

CHALFONT: Definitely. They seem to be all over England and Wales. Holland is emerging as their distribution center.

USA TODAY: Ultimately, what will the plan do for Europe?

CHALFONT: In the past, there was a great deal of unnecessary competition going on in the EC. We decided we've got to standardize and give European firms a chance to compete with the USA and Japan. By the year 2000, this effort will make Europe the major economic center of the world.

BEAR RALLIES: A bull market wants to advance while taking as few stockholders along with it as possible. The bull accomplishes this by scaring investors. He scares them with the proverbial "wall of worry." The bear wants exactly the opposite. The bear wants to decline while taking as many stockholders with him as he can. He accomplishes this with "a basket of hopes, dreams, and desires." Bear markets are particularly vicious (psychologically speaking) because they prey on mankind's innate optimism. Psychologists tell us that a person cannot fully conceive of his or her own death. By the same token, it is very difficult for a person to fully conceive or accept the market's death (and that really is what a bear market amounts to).

For instance, ponder the optimism that enveloped Wall Street prior to the 1987 crash. Wall Street and the nation were lost in a wild orgy of optimism which included mergers and acquisitions, absurd leverage and loans, huge expansions at brokerage houses, etc. Nobody at the time remembered the history of Wall Street which has always been one of feast or famine. So if Wall Street can't remember its own history, how can we expect the average investor to remember the dangers inherent in a primary bear market? The answer is that we can't.

All this the bear uses to his advantage. Right now the stock market is rallying, and the bear is trying his best to keep stockholders optimistic while at the same time bringing new buyers into the fold. The public is confused by the market rally, and the professionals are hoping that the bull is somehow reviving. Both groups are

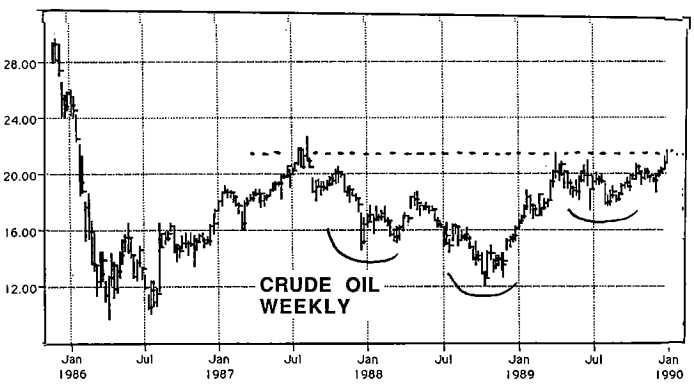
probably wrong. But the bear will try his hardest to convince both groups that they are correct. This is the essence of the rally (upward correction) in a bear market.

Robert Rhea, the great Dow Theorist of the 1930s, wrote that the rally in a bear market can be powerful and convincing, "often looking better than the real thing." Believe it. And know what you are looking at. Money can be made during bear market rallies. But these rallies are tricky. My own experience with bear rallies is that if I continue to play them, I end up losing money. I know they're frustrating, and I know they play on our greed. But I tell myself, "The bear is a bear, and he wants us in there." Our defenses against the bear are knowledge, discipline, and experience.

OIL: (1) Oil consumption in the US and in the rest of the world keeps growing. (2) As Eastern Europe become industrialized, it will need increasing amounts of oil, lots of it. (3) The US is now importing more oil than it brings out of the ground, and shortly the US will be importing better than 50% of all its oil needs (it imports 46% now). (4) Russian oil production (they are the world's largest producers) is declining.

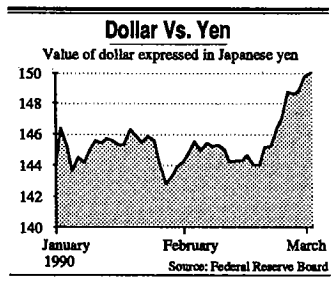
(5) Due to a sensational new technology, little discussed outside of oil circles, US oil producers are now able to drill horizontally. The new-technique drills can bore down and then slowly curve horizontally, thus cutting across many oil-filled fissures in the rock. This has increased the oil take from certain wells up to four times.

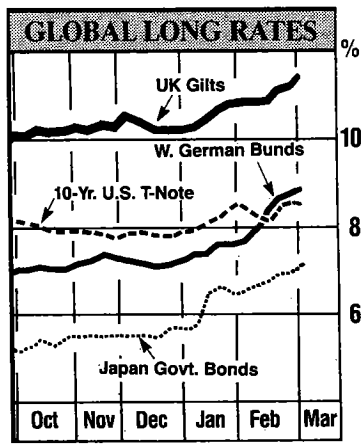
(6) Finally, the price of oil has been strong, as you can see from this chart courtesy of *Dunn & Hargitt.*



Result: Things are looking up in the oil country from Texas to Oklahoma, from Louisiana to Colorado. In addition, the oil and gas producing groups and the oil refiners as well as oil drill suppliers are the strongest segments of the market. In the 30 Dow stocks, Texaco and Chevron are the strongest with Exxon somewhat behind because of their oil-spill troubles. If I was ready to buy oil and oil-related stocks, I'd be looking at Halliburton, Schlumberger, Royal Dutch, Mobil, Atlantic-Richfield, plus the Dow oils.

INT'L DEVELOPMENTS (or nothing happens according to the script): Suddenly it's the new strong dollar, a dollar at a two-year high against the yen. And suddenly, investors world-wide are having doubts about the Japanese miracle. Why, what's happening? It's not that the US is doing anything right, it's what's happening overseas. In Japan, the Liberal Democratic Party is being wishy-washy on interest rates. The huge Bank of Japan wants rates higher and the powerful Finance Ministry wants rates steady. The Ministry is afraid of what a higher Japanese discount rate will do to their already wobbly stock market. Conversely, the bank is afraid that current low Japanese rates won't support the yen, which is now fading against the dollar (see accompanying chart courtesy of *Investor's Daily*). A declining yen is inflationary since it means Japan pays more for imports, particularly its massive imports of oil.





In West Germany, they are beginning to add up what unification will cost in terms of the Deutsche mark -- and it's a lot. Consequently, the mark has turned weak. Note on the chart the rise in German and Japanese long-term interest rates. It's the rise no one expected, least of all the US bond market (chart courtesy of *Barron's*).

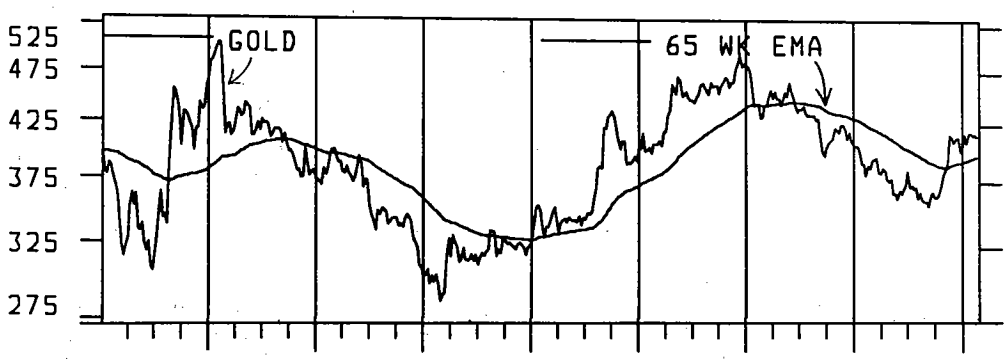
Meanwhile, many of the world's stock markets are turning weak. Hong Kong looks toppy, as does Britain, the Netherlands, France, Sweden, Spain, Switzerland. Most of the single-country closed-end funds are now being hit hard, not a good sign. (I feel the action is indicative of a slowly emerging global bear market.)

GOLD: Short-term, gold has been hit by Japanese selling of precious metals (specifically platinum). The metals have been dumped to cover losses in their stock and bond markets. As platinum sank, the weakness rubbed off on gold and silver. But that's short-term.

I've included a long-term semi-log chart of gold courtesy of *Pring's Market Review.* Here we see gold and its 65-week exponential moving average. Note what happened back in 1986 when gold last broke up and above its 65-week MA. After the breakout, gold backed and filled, and slumped twice, each time testing the MA.

Now look at the latest upside breakout. Gold surged above the 65-week MA, but it hasn't tested that line yet. At about 400, gold will come in contact with its MA, and it looks as if this is about what we're getting now. It's normal for gold, following the breakout from a base, to push above its 65-week MA (this is the bull signal), but then mess around for months, testing and retesting the rising MA before taking off to points north.

Gold isn't going out of style. It's just being battered around, and we better get used to this kind of action, at least for a while. In the meantime, continue dollar-averaging those coins. I consider gold cheap in this area.



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